Focus on the Family

Gift & Estate Planning

Giving Through Charitable Remainder Trusts

Stewarding the Giver **and** The Gift℠ >>

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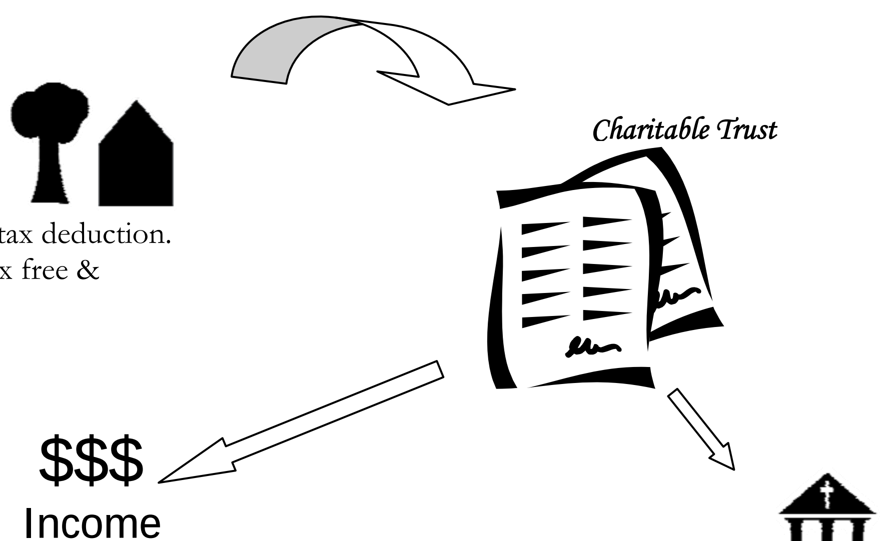
GIVING THROUGH
CHARITABLE REMAINDER TRUSTS

A Charitable Remainder Trust can be highly a effective giving tool for individuals who want to sell an appreciated asset, avoid tax on the sale, reinvest the proceeds, live off the income of the reinvested proceeds and ultimately make a generous gift to charity. If you need income for life from an asset but eventually want to give the remainder balance of the asset to charity, a Charitable Remainder Trust could be an ideal giving arrangement for you.

What is a Charitable Remainder Trust?

A Charitable Remainder Trust (CRT) is a unique trust arrangement through which you can contribute your assets and still retain the right to receive income payments from the assets for a predetermined period of time. At the end of the income interest period, the CRT terminates, and the remaining trust assets are distributed to the charities you have chosen. When you contribute assets to a CRT, you receive a ***current*** income tax deduction equal to the present value of the gift the charity will eventually receive when the CRT terminates. Because CRTs are generally tax exempt, appreciated assets can be gifted to a CRT and later sold without you or the trust owing capital gains tax.

Here's how it works.



1. John and Mary transfer their appreciated property into a CRT and receive an immediate tax deduction. The trustee sells the property tax free & invests 100% of the proceeds.

2. The CRT pays an income interest to John and Mary for their remaining lives

3. After John's and Mary's deaths, the remaining trust assets are distributed to their chosen charities

When creating your CRT, you will need to determine how long the income interest payments need to be made from the CRT. In most cases, the income interest will be paid to you for life (and/or for the lifetimes of one or more other persons designated by you). Alternatively, you may choose to direct that the income interest be paid for a specified period of time not to exceed 20 years. You can even require the income interest be paid over a certain combination of lives and terms of years. Once the specified income interest has concluded, the CRT terminates, and the remaining trust assets are distributed to the charities you have chosen.

In addition to having the flexibility of determining how long, and to whom, the income interest payments will be made, you also have the ability to determine how the income interest will be calculated. There are two primary types of CRTs which are characterized by the way the income interest is determined each year.

- ***Charitable Remainder Annuity Trusts (CRAT)*** – You may design the CRT income interest so that the actual dollar amount distributed to you (and/or other persons you have designated as non-charitable income beneficiaries) is fixed at the time the trust is created and funded. This type of CRT is generally referred to as a Charitable Remainder Annuity Trust because the income interest is a pre-established annuity amount that will not change regardless of how the CRT assets may fluctuate in value. A Charitable Remainder Annuity Trust can be especially appealing for a donor who needs a specific amount of income and who is significantly concerned about the possibility of experiencing change in their income payments.

- ***Charitable Remainder Unitrusts (CRUT)*** - Alternatively, you may design the CRT income interest so that the amount distributed to you is recalculated each year based upon a fixed percentage of the trust's fair market value for that year. This type of CRT is generally referred to as a Charitable Remainder Unitrust. It is important to understand that with a Charitable Remainder Unitrust, the income interest is not a fixed "annuity payment." Though the fixed percentage will never change, the amount you receive can fluctuate. If the CRT investments perform well, the trust assets increase in value and so does the income interest payment which is calculated as a fixed percentage of the increased trust value. However, the inverse is also true. If the trust decreases in value, the income interest payment is similarly affected since it is calculated as a fixed percentage of the reduced trust value. A Charitable Remainder Unitrust can be especially appealing for the investment-minded individual who wants to benefit from increased income payments resulting from the long-term appreciation of the trust assets.

The difference between the Charitable Remainder Annuity Trust and the Charitable Remainder Unitrust can be seen in the following example:

Year	Value of Trust Assets	6.5% CRAT Income Interest	6.5% CRUT Income Interest
2006	$500,000	$32,500	$32,500
2007	$510,000	$32,500	$33,150
2008	$536,000	$32,500	$34,840
2009	$564,000	$32,500	$36,660
2010*	$495,000	$32,500	$32,175

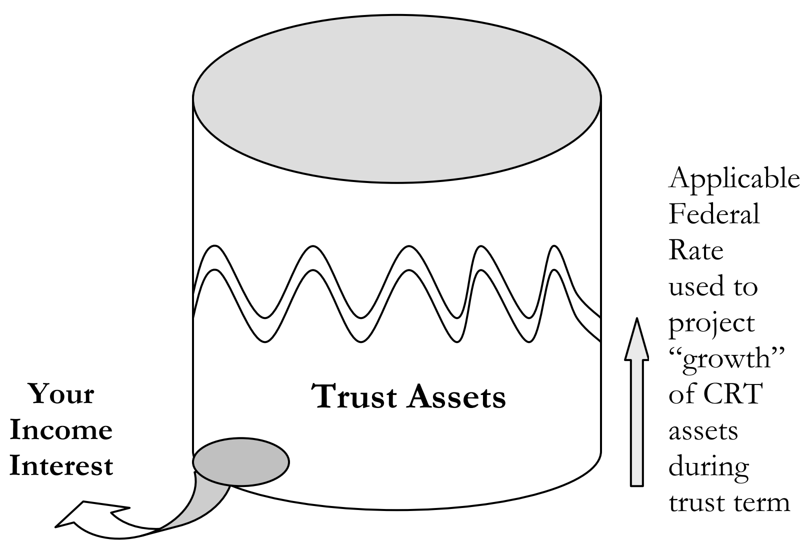
** Investment markets experienced a widespread downtown in performance*

Can I pick any fixed percentage for calculating my retained income interest?

The fixed percentage must be at least 5% and not more than 50%. However, within that range, the IRS imposes an additional requirement that the initial "present value" (as determined under IRS guidelines) of the charity's remainder interest must be no less than 10% of the value of the assets contributed to the CRT. What does this mean? Basically, that the IRS wants to be sure there is a minimal value left in the CRT for the charity at the end of the income interest. Why does this impact the maximum fixed percentage for calculating the CRT income interest?

Imagine for a moment that the CRT is a bucket . . .

You have placed assets into the CRT "bucket" but there is a hole in the bottom through which an income stream pays back to you your income interest. If the hole is too large (i.e. the income interest fixed percentage is too large) and it is open for too long (i.e. the duration of the income interest is for a long period of time), there could be no assets left in the bucket for the charity when the "hole is stopped up" (i.e. when the income interest ceases).



For this reason, a longer income term (resulting from naming multiple income recipients or younger income recipients) will generally result in a lower maximum fixed percentage payout.
By comparison, a shorter income term, will allow for a larger maximum fixed percentage payout because there will be less time available to deplete the CRT assets.

Are the investments in my Charitable Remainder Trust taxable?

Yes and No. One of the advantages of investing in a CRT is that CRTs are generally tax exempt. Therefore, any income and appreciation not distributed as part of the CRT income interest are retained tax free within the trust for future growth and income generation. However, once the income is distributed from the trust to the income interest recipients, the distribution will generally be taxable to the recipient. The tax treatment of the income interest payments is based upon an accounting method unique to CRTs. Accordingly, you should consult your tax professional regarding the tax implications to you of receiving the income interest payments from your CRT.

I need to increase my income. Can a Charitable Remainder Trust help me?

Generally, a CRT is an excellent tool to use when you are needing to reposition non-income producing assets into income producing assets. Prior to retirement, individuals often find their assets are largely held in growth-oriented investment portfolios or non-liquid asset holdings. However, when they reach retirement, they need these assets to produce more income. Unfortunately, the current assets have often increased in value, and the individuals face the dilemma of owing significant taxes if they sell the assets in order to reinvest the after-tax proceeds for a higher income yield.

As explained above, a CRT can be used to help you liquidate non-income producing assets without incurring capital gains tax liability. You can then reinvest the entire value of the liquidated assets for the purpose of generating an increased income.

Example:

David and Julie have $800,000 invested in a publicly traded stock they purchased several years ago for $160,000. The stock currently pays them with a 2% annual dividend resulting in $16,000 of supplemental income for them. David and Julie want to sell the stock and reinvest in publicly traded securities that are yielding a higher income return.

If David and Julie chose to sell the stock themselves, they will owe long term capital gains tax on the stock's increase in value in the amount of $96,000 ($800,000 – $160,000 x 15%) plus any applicable state taxes. They can then invest the after-tax net proceeds of $704,000 (assuming no state tax) to yield a 7% annual income resulting in $49,280 of supplemental income for them.

However, if David and Julie contribute the stock to a CRT, they will receive an income tax deduction in the year of the gift. The trust then sells the stock without incurring any capital gain taxes, and David and Julie draw an annual income interest of 7% of the trust's $800,000 value resulting in $56,000 of supplemental income for David and Julie.

By contributing the stock to a CRT, David and Julie not only make a major gift to charity but they also receive approximately 14% more income than if they had sold the stock themselves.

How can I find out more about whether a Charitable Remainder Trust could help me accomplish my charitable giving and tax planning goals?

Please contact Focus's Gift & Estate Planning department at (800) 782-8227. We welcome the opportunity to answer your questions, and we will gladly prepare for you a personal Charitable Remainder Trust proposal for you to discuss with your professional tax advisor and legal advisor.